



February 14, 2011

AGENDA ITEM 2

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** December 2010 Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION** That the Investment Committee approve:
 - a. Revision of the Policy for the Barclays Aggregate Program
 - b. Revision of Synthetic Enhanced Equity Strategy Policies
 - 1) Internally Managed Global Enhanced Equity Strategies Policy
 - 2) Low Duration Fixed Income Program Policy
- IV. ANALYSIS:**

Background

The Policy Subcommittee met on December 14, 2010 to review proposed revisions to the Barclays Aggregate Program policy. In addition, the Synthetic Enhanced Equity Strategy Policies, consisting of the Internally Managed Global Enhanced Equity Strategies Policy and the Low Duration Fixed Income Policy, were reviewed as one related item. A discussion was also held regarding the Roles of Investment Consultants.

The revised policies and the role of private asset class investment consultants presentation are attached. Unless otherwise noted, the revised policy is presented as a black-lined version from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double

underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Discussion of the Role of Investment Consultants

In prior meetings, staff was directed to prepare an agenda item describing the role of our private asset class investment consultants and explore the independence and the economics surrounding consultant roles. A presentation (Attachment 1) was provided to the Subcommittee and additional agenda items will be provided at future meetings to continue discussion about the roles of investment consultants.

Revision of Policy for Barclays Aggregate Program

The Barclay's Aggregate Program Policy (Tab 2a) covers the internal actively managed fixed income portfolio managed against the Barclay's Aggregate Index. The Policy for the Global Fixed Income Program was revised through a reduction in ranges and flexibility of active management parameters (effective September 13, 2010). Staff has proposed similar reductions in ranges and flexibility of active management parameters for Barclay's Aggregate Program Policy in order to reduce risk and maintain consistency among the different fixed income policies.

The Subcommittee recommends approval of the revised Policy for Barclays Aggregate Program.

Approval of the revisions to the Policies on Synthetic Enhanced Equity Strategy

This item entails recommended revisions to the Statement of Investment Policy for Internally Managed Global Enhanced Equity Strategies Policy and the Low Duration Fixed Income Program. These two policies (Tab 2b) guide the Synthetic Enhanced equity strategy and are managed jointly by the Global Equity and Global Fixed Income investment teams.

Staff recommends three revisions to the Internally Managed Global Enhanced Equity Strategy Policy:

- Limit the size of the strategy to 5% of the Global Equity asset class at the time of purchase. If the exposure reaches 10%, it would trigger a plan to reduce the strategy back to the 5% limit
- Clarify the language regarding which equity index derivatives are used
- Provide reference to the overall plan leverage policy

The Low Duration Fixed Income Program is adding a new low liquidity, low duration fund called the Low Liquidity Enhanced Return Fund (LLER). The LLER complements the current higher liquidity High Quality LIBOR and Short Duration programs. The LLER Program is designed for participants that require low to no liquidity and will only be appropriate for holdings that are not expected to be liquidated.

Given the LLER hold-to-maturity mandate, and the illiquid nature of the underlying investments, Staff believes that performing policy compliance

calculations at the time of security purchase is acceptable. Staff further believes that the use of this strategy should be limited to a small percentage (5% as stated above) of the asset class employing the strategy due to the increased credit risk and illiquidity of the underlying securities.

The Subcommittee recommends approval of the revised Policies for the Synthetic Enhanced Equity Strategy.

V. STRATEGIC PLAN:

This item will further the following goals of CalPERS Strategic Plan:

Goal I: Exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems.

Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second to minimize and stabilize contributions.

Goal IX: Achieve long term, sustainable, risk-adjusted returns.

VI. RESULTS/COSTS:

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

Members of the Investment Committee
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